

**ARIZONA HEALTH CARE  
COST CONTAINMENT SYSTEM**

FINANCIAL STATEMENTS  
AND ADDITIONAL INFORMATION

Year Ended June 30, 2002

# **ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM**

## **FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION**

Year Ended June 30, 2002

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## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Arizona Health Care Cost Containment System (AHCCCS) provides this *Management's Discussion and Analysis* for the benefit of the readers of the AHCCCS financial statements. This narrative overview and analysis of the financial activities of AHCCCS is for the fiscal year ended June 30, 2002. We encourage readers to consider this information in conjunction with the basic financial statements and related footnotes which follow this section.

Because AHCCCS is implementing new reporting standards for the financial statements for this fiscal year in accordance with Governmental Accounting Standards Board (GASB) No. 34, *Basic Financial Statements and Managements' Discussion and Analysis for State and Local Governments*, much of the information is not easily comparable to prior years. GASB No. 34 requires significant changes in both the content and structure of the financial statements. Such information is not readily available for the prior year financial statements. However, in future years, the financial statements will be presented in a more consistent and comparable manner. This will allow for greater discussion of AHCCCS' financial position and results of operations.

### Financial Highlights

#### **Government-Wide:**

*Net Assets* - The assets of AHCCCS exceeded its liabilities at fiscal year ending June 30, 2002 by \$92.8 million (presented as "net assets"). Of this amount, \$82.1 million was reported as "unrestricted net assets". Unrestricted net assets represent the amount available to be used to meet AHCCCS' ongoing general obligations to members and creditors. The remaining net assets include the net amount invested in capital of \$5 million and \$5.6 million in restricted net assets.

*Changes in Net Assets* - AHCCCS' total net assets decreased by \$97.3 million (a 51.1 percent decrease). The decrease is attributable to the full-year implementation of a voter approved initiative (Proposition 204) that expended nearly all of the tobacco litigation settlement revenue carryforward (\$72.5 million) from the previous fiscal year and partial funding of the fiscal year 2002 Title XIX program deficit from the Medical Services Stabilization Fund.

#### **Fund Level:**

*Governmental Funds - Fund Balances* - As of the close of fiscal year 2002, AHCCCS' governmental funds reported a combined ending fund balance of \$86.9 million, a decrease of \$96.3 million (a 52.5 percent decrease) in comparison with the prior year. At the end of the fiscal year, unreserved fund balance for the General Fund was \$22.9 million, which is less than 1% of the total general fund expenditures.

*Propriety Fund - Fund Balance* - The propriety fund reported net assets of \$2.2 million, a decrease of \$1.0 million in comparison with the prior year.

### Overview of the Financial Statements

This discussion and analysis is an introduction to AHCCCS' basic financial statements, which is comprised of three components: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements.

#### **Government-Wide Financial Statements**

The Government-Wide Financial Statements are designed to provide readers with a broad overview of AHCCCS' finances in a manner similar to a private-sector business. The Statement of Net Assets and the Statement of Activities are two financial statements that report information about AHCCCS, as a whole, and about its activities that should help answer this question: is AHCCCS, as a whole, better off

or worse off as a result of this year's activities? These statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. They take into account all revenues and expenses connected with the fiscal year even if cash involved has not been received or paid.

The Statement Of Net Assets presents information on all of *AHCCCS'* assets and liabilities, with the difference between the two reported as "net assets". Over time, increases or decreases in net assets, along with other financial information, serve as indicators as to whether *AHCCCS'* financial position is improving or deteriorating.

The Statement Of Activities presents information showing how *AHCCCS'* net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g. incurred but not reported fee-for-service and reinsurance claims and earned but unused vacation leave).

Both statements report two categories:

- **Governmental Activities** - The activities in this category are primarily supported by state appropriations and federal and county intergovernmental revenues. The governmental activities of *AHCCCS* are specific to programs concentrated on the health and welfare of the citizens of Arizona. Most of *AHCCCS'* activities are reported in this category.
- **Business-Type Activities** - This category is comprised of the Healthcare Group operations. Members are charged a premium for the health care coverage provided. The state also subsidizes this program with an appropriation from the Tobacco Tax and Health Care Fund Medically Needy Account.

The government-wide financial statements can be found on pages 11 and 12.

### **Fund Financial Statements**

A fund is a fiscal and accounting entity with a self-balancing set of accounts that *AHCCCS* uses to keep track of specific sources of funding and spending for specific activities or objectives. *AHCCCS*, like other state agencies, uses fund accounting to ensure and demonstrate compliance with legislative appropriation funding requirements. All of the funds of *AHCCCS* can be divided into two categories: governmental funds and the proprietary fund.

**Governmental funds** - Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental funds financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These financial statements provide a detailed short-term view of *AHCCCS'* finances that assists management in determining whether there will be adequate financial resources available to meet *AHCCCS'* current needs.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the state of Arizona's near-term financial decisions. The governmental fund balance sheet provides a reconciliation to facilitate this comparison between governmental funds and governmental activities. This reconciliation is presented on the governmental fund financial statement. The governmental fund statement of revenues, expenditures, and changes in fund balances reconciles to the government-wide statement of activities. The basic governmental fund financial statements can be found on pages 13 and 14 of this report.

AHCCCS reports three governmental funds categories. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund, major fund and other funds.

The Legislature adopts an appropriated budget for AHCCCS at the acute care and long-term care programs, the administration program, and other special line item programs level. The annual appropriation is made separately for both the state matching funds and federal financial participation funds from Social Security Act Titles XIX (Medicaid) and XXI (State Children's Health Insurance Program). A budgetary comparison statement has been provided for the General Fund and Tobacco Tax – Medically Needy Fund to demonstrate compliance with the budget.

**Proprietary fund** - This fund is used to account for activities that generate charges from customers for the services that are provided. Proprietary funds are prepared using the flow of economic resources measurement focus and the accrual basis of accounting; the same method used by private sector businesses. There is no reconciliation needed between the government-wide financial statements for business-type activities and the propriety fund financial statements.

AHCCCS maintains one proprietary fund that is classified as an enterprise fund. Under this fund, AHCCCS provides health insurance coverage for qualifying private citizens and business organizations outside of state government. The basic proprietary fund financial statements can be found on pages 17 through 19 of this report.

## Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 20 to 31.

### Government-Wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of AHCCCS, assets exceeded liabilities by \$92.8 million at June 30, 2002.

#### Net Assets as of June 30, 2002 (in thousands of dollars)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Current assets	\$ 400,422	\$ 5,956	\$ 406,378
Capital assets	4,977	13	4,990
Total assets	<u>\$ 405,399</u>	<u>\$ 5,969</u>	<u>\$ 411,368</u>
Current liabilities	314,831	3,774	318,605
Total liabilities	<u>\$ 314,831</u>	<u>\$ 3,774</u>	<u>\$ 318,605</u>
Net assets:			
Invested in capital assets, net of depreciation	\$ 4,977	\$ 13	\$ 4,990
Restricted	3,461	2,182	5,643
Unrestricted	82,130	-	82,130
Total net assets	<u>\$ 90,568</u>	<u>\$ 2,195</u>	<u>\$ 92,763</u>

By far the largest portion of AHCCCS' net assets (72.9 percent) reflects cash available for future fiscal years' appropriations and program allocations from the Budget Neutrality Compliance Fund (General Fund) and the Tobacco Tax and Health Care Fund Medically Needy Account (Major Fund). AHCCCS will use this available cash as a funding source for the Proposition 204 program and to fund allocations to

AHCCCS and other state of Arizona agencies for programs as required by Arizona Revised Statutes and Session Law. The cash attributable to the Medically Needy Account was derived from a voter-approved 40 cents per pack cigarette/tobacco product tax.

An additional portion of AHCCCS' net assets (9.4 percent) represents resources that are subject to legal restrictions on how they may be used. Such restrictions include but are not limited to funding appropriations made to other state agencies in fiscal year 2003. The remaining balance of unrestricted net assets (17.7 percent) may be used to meet AHCCCS' ongoing general obligations for health programs.

Change in Net Assets  
Year Ended June 30, 2002  
(in thousands of dollars)

	Governmental Activities	Business-type Activities	Total
Revenues:			
Charges for services	\$ 4,248	\$ 21,244	\$ 25,492
Contributions	376,185	-	376,185
Grants	2,504,620	-	2,504,620
General revenues:			
State appropriations	796,383	-	796,383
County government	<u>77,876</u>	<u>-</u>	<u>77,876</u>
Total revenues	3,759,312	21,244	3,780,556
Expenses:			
General government	<u>3,827,820</u>	<u>24,273</u>	<u>3,852,093</u>
Excess (deficiency) before transfers	(68,508)	(3,029)	(71,537)
Transfers, net	<u>(27,761)</u>	<u>2,032</u>	<u>(25,729)</u>
Change in net assets	(96,269)	(997)	(97,266)
Net assets - beginning (restated)	186,837	3,192	190,029
Net assets - ending	<u>\$ 90,568</u>	<u>\$ 2,195</u>	<u>\$ 92,763</u>

At June 30, 2002, AHCCCS reported positive balances in net assets for the agency as a whole, as well as for its separate governmental and business-type activities.

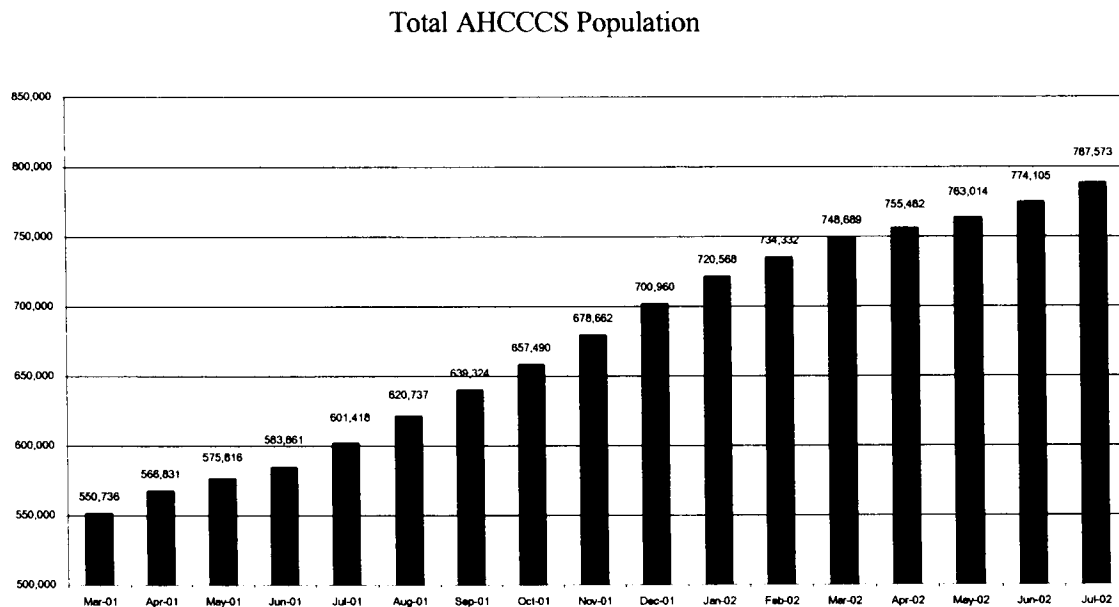
There was a \$997,000 decrease in restricted net assets reported in connection with AHCCCS' business-type activity. The decrease resulted from the transfer out from the Healthcare Group Fund of the prior year reinsurance subsidy from the Arizona Tobacco Litigation Settlement Fund (ATLS fund) that reverted back to the ATLS fund. The legislatively approved \$8.0 million subsidy was transferred to the operating account in the prior fiscal year. Final reinsurance expenses totaled \$4.992 million with the unused subsidy balance legally reverting to the originating funding source occurring in this fiscal year. The 2002 subsidy is up to \$6.0 million and has been reduced to \$5.0 million for the upcoming fiscal year.

As previously noted, AHCCCS' net assets decreased by \$97.3 million during the current fiscal year. The decrease is attributable to the full-year implementation of a voter approved initiative (Proposition 204) that required expenditure of all of the tobacco litigation settlement revenue carry forward (\$72.5 million) from the previous fiscal year and funding of the current year Title XIX program State match deficit from the Medical Services Stabilization Fund.

## Governmental Activities

Governmental expense activities account for over 99 percent of *AHCCCS*' programs. These activities resulted in a decrease in net assets by \$96.3 million and accounted for 99 percent of the total reduction in net assets. Key elements of this decrease are attributable to unprecedented growth in the *AHCCCS* program. Since just prior to the implementation of Proposition 204, a ballot initiative passed by voters on November 7, 2000, to expand the Title XIX Medicaid program, the overall program population has increased by 236,900 members to 787,600, a 43 percent growth rate. The initiative resulted in 78,600 (34 percent) new *AHCCCS* program members.

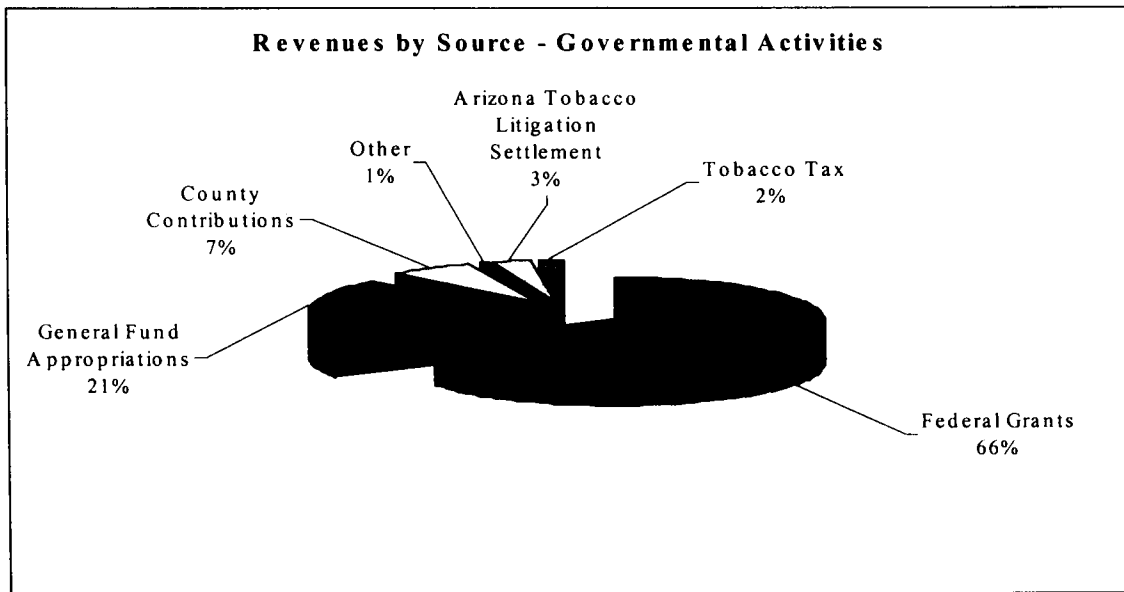
The following chart depicts *AHCCCS* enrollment growth since implementation of Proposition 204:



- The cost of health care programs including Title XIX Medicaid and Title XXI SCHIP totaled \$3,827.8 million in fiscal 2002. As shown in the Statement of Activities, the amount funded as grants through the Centers for Medicare and Medicaid Services (CMS) was \$2,504.6 million (65.4 percent) in fiscal 2002. Funding in the form of federal financial participation is determined through the Federal Medical Assistance Percentages (FMAP) used to provide the amount of Federal matching for State medical assistance expenditures. The FMAP or federal share of program costs is based on the relationship between Arizona's per capita personal income and the national average per capita personal income over three calendar years. The FMAP is recalculated each year and decreased by .79 percent to 64.98% from the prior year's rate.
- State and County funding sources combined to provide \$1,254.7 million in State appropriations in fiscal 2002. State General Fund revenues raised in the form of sales and income taxes directed to *AHCCCS* amounted to \$551 million and an additional \$245 million was passed through from other State agencies in order to provide the State's share for Title XIX Medicaid eligible medical assistance expenditures. Arizona Counties contributed \$241 million as determined by legislative formula. An additional \$112 million in State revenue funding was provided by the annual payments awarded to *AHCCCS* as administrator of the Arizona Tobacco Litigation Settlement Funds awarded to Arizona.



The following chart depicts revenues of the governmental activities for the fiscal year:



### **Business-Type Activities**

As previously noted, the business-type activity decreased AHCCCS' net assets by \$997 thousand. The decrease resulted from the transfer-out of the prior year reinsurance subsidy legally obligated to be reverted back to the Arizona Tobacco Litigation Settlement Fund. The sole business-type activity for AHCCCS is the Healthcare Group (HCG). The HCG administers a prepaid medical coverage program primarily to small businesses with 1 to 50 employees and employees of political subdivisions. It charges a premium to participating employers; however, the premium currently is not sufficient to fully pay for medical services provided. The shortfall is subsidized by appropriations from the State. The approved subsidy for the current fiscal year is \$6 million of which \$3.486 million is included as expenses in the government-wide Statement of Activities. The approved fiscal year 2003 subsidy has been reduced to \$5 million. Enrollment increased by 1.94 percent over the previous fiscal year.

### **Financial Analysis of AHCCCS' Funds**

#### **Governmental Funds**

At the end of the fiscal year 2002, AHCCCS' governmental funds reported combined ending fund balances totaling \$86.859 million, a decrease of \$96.269 million in comparison with the prior year. As previously noted, the decrease is attributable to a full-year's activity for Proposition 204 that expended all of the tobacco litigation settlement revenue carry forward balance of \$72.456 million from the previous fiscal year and funding of the Title XIX program State match deficit from the Medical Services Stabilization Fund.

The *general fund* is the chief operating fund of the AHCCCS Acute Care, Proposition 204 and Long-Term Care programs. At the end of fiscal year 2002, the unrestricted fund balance of the general fund was \$19.805 million. The total fund balance of AHCCCS' general fund decreased by \$49.549 million this fiscal year. The key factor in this decrease was the increase in the Proposition 204 program population of 57,600 (75.8 percent) over the prior fiscal year's ending enrollment. The primary revenue source for the program is from the annual tobacco litigation settlement proceeds, which totaled \$111.955 million for the current year. A State general fund appropriation of \$70 million was provided to supplement the State match funding and accounts for the ending general fund unrestricted fund balance.

The *major fund* consists of the medically needy account of the Tobacco Tax and Health Care Fund. Its unrestricted fund balance is \$47.821 million at yearend and represents 57 percent of the total governmental fund's unrestricted fund balance. Revenues consist of a tax on cigarettes and other related tobacco products that generated \$76.417 million for the current year and accounts for 86.9 percent of the total Tobacco Tax – Medically Needy Fund revenues; interest earned on invested balances; and a transfer-in from another fund.

The *other governmental funds* consists of six individual funds that have a combined total fund balance of \$16.131 million, of which \$12.670 million is unrestricted and available to meet future year obligations. The restricted amount of \$2.5 million is an appropriated funding source obligated to another State agency and the balance represents cash advances from the State of Hawaii for projected expenditures of the Hawaii Arizona PMMIS Alliance Intergovernmental Service Agreement. The ending fund balance decreased by \$45.388 million. Of this amount, the Medical Services Stabilization Fund provided \$36.206 million during the current year to partially fund the general fund Acute Care Title XIX program supplemental appropriation. The remaining decrease is attributable to a one-time transfer of fund balance to the State's general fund and program operations funded from reserves carried forward from prior fiscal years.

### **General Fund Budgetary Highlights**

Differences between the original and the final amended programmatic budget (\$85.4 million) were not insignificant and are attributable to the unprecedented growth in enrollment in the Title XIX Medicaid programs. The major revisions can be briefly summarized as follows:

- \$72.142 million increase to capitation payments
- \$46.724 million decrease to the fee-for-service payments
- \$54.249 million increase to disproportionate share hospital payments

Of this increase, \$24.003 million is funded by the general fund and \$4.636 million is funded from increases in the County contributions for the Acute and Long-Term Care programs. The remaining \$52.768 million represents federal expenditures funded by Federal grant revenue. At year-end, actual cash basis expenditures were less than budgetary estimates, thus providing carry forward balances that are available to be used for administrative adjustments as authorized by State statute.

### **Capital Asset Administration**

AHCCCS' investment in capital assets for its governmental and business type activities as of June 30, 2002 amounts to \$4.990 million (net of accumulated depreciation). This investment in capital assets only includes furniture, vehicles and equipment as land, buildings and improvements are under the management of the state of Arizona and are accounted for on the State's comprehensive annual financial report. The total increase in AHCCCS' investment in capital assets for the current fiscal year was 13.5 percent.

#### **Capital Assets as of June 30, 2002** (net of depreciation, in thousands of dollars)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Vehicles	\$ 1,465	\$ -	\$ 1,465
Furniture and equipment	3,512	13	3,525
Total net assets	<u>\$ 4,977</u>	<u>\$ 13</u>	<u>\$ 4,990</u>

Additional information on AHCCCS' capital assets can be found in Note 5 in the accompanying financial statements on page 24.

### **Long-Term Contingent Liability**

AHCCCS obtained a waiver from the Centers for Medicare and Medicaid Services (CMS) to receive Federal funding for the non-categorically eligible populations and to fund additional legislation passed during the 2001 State legislative session to implement Proposition 204. The CMS waiver requires that the newly covered population that is not categorically eligible for Medicaid be budget neutral for CMS. Budget Neutral means that CMS will not pay more for medical services with the waiver population than it would without it. The waiver period for budget neutrality began April 1, 2001 and extends through Federal fiscal year 2006 at which time any Federal funds received by the State that exceed the negotiated budget neutrality limit must be refunded to CMS. Current estimates at June 30, 2002 project zero liability and as any future settlement amount is currently not determinable, no liability has been recorded.

### **Economic Factors and Next Years Budgets and Rates**

- Since March 1, 2001 just prior to the implementation of Phase I of Proposition 204, the AHCCCS population was approximately 550,700 and has increased by 236,900 members to 787,600. This represented a 43 percent program enrollment growth by fiscal year end. The primary forces behind the growth are the newly eligible Proposition 204 population, woodwork effect from Proposition 204 and the economic slowdown. These growth drivers are expected to continue into fiscal year 2003.
- Certain member categories are projected to incur strong growth. The AHCCCS care population grew from 13,000 in April 2001 (Phase I of Proposition 204) to 47,000 in June 2002 and is projected to grow by 22.5 percent by June 2003. This population was previously uninsured, thus, capitation rates are higher and have a greater impact on the overall costs to the general fund.
- The recession has contributed to the increase in the AHCCCS populations. For example, in the current fiscal year, the 1931 (TANF) population increase averaged 5,840 members per month and is projected to grow at an approximate 15 percent rate from June 2002 to June 2003. Without an economic recovery, it is projected that the Acute Care enrollment will remain at historically high levels.
- Inflationary trends for health care costs are incorporated in the rate development process for the managed care organization capitation rates. Capitation rate inflation for the October 1, 2001 to September 30, 2002 contract year was approximately 7 percent. The fiscal year 2003 inflation increase is 4.4 percent for the contract year beginning October 1, 2002. The inflation rate is indicative of medical inflation including the rising costs of pharmaceuticals. There was no increase in the prior period capitation rate in the current year. These rates will increase by 6.2 percent in fiscal year 2003. The key components in determining rate increases are: 1) medical inflation, 2) pharmacy costs (nationwide, pharmacy costs are on the rise at a rate of 14 to 20 percent), 3) rising cost of new technology, 4) an aging population, and 5) newly eligible and woodwork populations that resulted from Proposition 204 which are assumed to have higher initial costs due to pent-up demand.

All of these factors were considered in preparing the AHCCCS' budget for fiscal year 2003. However, it is anticipated that AHCCCS will require a supplemental appropriation in fiscal year 2003.

### **Request for Information**

This financial report is designed to provide a general overview of AHCCCS' finances for the State's citizens, taxpayers and AHCCCS' members, providers and creditors. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Arizona Health Care Cost Containment System, Division of Business and Finance, Attention: Finance Administrator MD 5400, 701 East Jefferson, Phoenix, Arizona 85034.

## **INDEPENDENT AUDITORS' REPORT**



## INDEPENDENT AUDITORS' REPORT

To the Director of the  
***Arizona Health Care Cost Containment System***

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the major fund, and the aggregate remaining fund information of

**ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM**  
***(AHCCCS, an agency of the state of Arizona)***

at and for the year ended June 30, 2002, as shown on pages 11 through 19. These financial statements and the schedule referred to below are the responsibility of **AHCCCS'** management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit. The statement of revenue, expenses, and changes in fund net assets – proprietary fund for the year ended June 30, 2001 was audited by other auditors whose report dated November 29, 2001 expressed an unqualified opinion on that statement. As discussed in Note 18 to the financial statements, **AHCCCS** has restated its June 30, 2001 statement of revenues, expenses, and changes in fund net assets – proprietary fund during the current year to reflect additional claims expense that existed as of that date. The other auditors reported on the June 30, 2001 statement of revenues, expenses, and changes in fund net assets – proprietary fund before the restatement.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the financial statements of **AHCCCS** are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, the major fund, and the aggregate remaining fund information of the state of Arizona that is attributable to the transactions of **AHCCCS**. They do not purport to, and do not, present fairly the financial position of the state of Arizona as of June 30, 2002, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the major fund, and the aggregate remaining fund information of **AHCCCS** at June 30, 2002, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the general and major funds for the year then ended in conformity with U.S. generally accepted accounting principles.

The accompanying management's discussion and analysis on pages 1 through 8 and the budgetary comparison information on pages 15 and 16 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise **AHCCCS'** basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 27, 2002, on our consideration of **AHCCCS'** internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

As described in Note 16, **AHCCCS** has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as of June 30, 2002.

We also audited the adjustment described in Note 18 that was applied to restate the June 30, 2001 statement of revenues, expenses, and change in fund net assets – proprietary fund. In our opinion, such adjustment is appropriate and has been properly applied.

This report is intended solely for the information and use of **AHCCCS** and the state of Arizona Auditor General and is not intended to be and should not be used by anyone other than these specified parties.

November 27, 2002  
Phoenix, Arizona

*Miller Wagner & Company, PLLC*

## **BASIC FINANCIAL STATEMENTS**

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## STATEMENT OF NET ASSETS

June 30, 2002  
(amounts expressed in thousands)

<u>ASSETS</u>	Governmental Activities	Business-type Activities	Total
<b>CURRENT ASSETS</b>			
Cash	\$ 126,164	\$ 4,022	\$ 130,186
Restricted cash	6,563	3,008	9,571
Due from state and county governments	77,372	-	77,372
Due from the federal government	188,755	-	188,755
Internal balances	1,095	(1,095)	-
Receivables and other	473	21	494
<b>TOTAL CURRENT ASSETS</b>	<b>400,422</b>	<b>5,956</b>	<b>406,378</b>
<b>CAPITAL ASSETS</b>			
Furniture, vehicles and equipment, net of accumulated depreciation	4,977	13	4,990
<b>TOTAL ASSETS</b>	<b>\$ 405,399</b>	<b>\$ 5,969</b>	<b>\$ 411,368</b>
 <u>LIABILITIES</u>			
<b>CURRENT LIABILITIES</b>			
Accounts payable	\$ 2,302	\$ 30	\$ 2,332
Other accrued liabilities	2,352	11	2,363
Deferred revenue	554	2,841	3,395
Due to federal, state and county governments	54,159	-	54,159
Accrued programmatic costs	252,716	855	253,571
Compensated absences due within one year	2,748	37	2,785
<b>TOTAL CURRENT LIABILITIES</b>	<b>\$ 314,831</b>	<b>\$ 3,774</b>	<b>\$ 318,605</b>
 <b>COMMITMENTS AND CONTINGENCIES</b>			
 <u>NET ASSETS</u>			
INVESTED IN CAPITAL ASSETS	\$ 4,977	\$ 13	\$ 4,990
RESTRICTED	6,563	2,182	8,745
UNRESTRICTED	79,028	-	79,028
<b>TOTAL NET ASSETS</b>	<b>\$ 90,568</b>	<b>\$ 2,195</b>	<b>\$ 92,763</b>

See Accompanying Notes to Financial Statements



# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## STATEMENT OF ACTIVITIES

Year Ended June 30, 2002  
(amounts expressed in thousands)

	Program Revenues				Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Appropriations Contributions	Grants	Governmental Activities	Business-type Activities	Total
PROGRAM REVENUES							
Government activities:							
Health care programs	\$ 3,827,820	\$ 4,248	\$ 376,185	\$ 2,504,620	\$ (942,767)	\$ -	\$ (942,767)
	<u>24,273</u>	<u>21,244</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(3,029)</u>	<u>(3,029)</u>
Business-type activities:							
Healthcare Group	\$ 3,852,093	\$ 25,492	\$ 376,185	\$ 2,504,620	<u>(942,767)</u>	<u>(3,029)</u>	<u>(945,796)</u>
TOTAL PROGRAM REVENUES							
General revenues:							
State appropriations					796,383	-	796,383
County government					-	-	-
Tobacco tax					77,876	-	77,876
					<u>874,259</u>	<u>-</u>	<u>874,259</u>
Transfers:							
Transfers in					70,350	-	70,350
Transfers out					(96,065)	(14)	(96,079)
Interfund transfers					(2,046)	2,046	-
Total general revenues and transfers					<u>846,498</u>	<u>2,032</u>	<u>848,530</u>
					<u>(96,269)</u>	<u>(997)</u>	<u>(97,266)</u>
CHANGE IN NET ASSETS							
NET ASSETS, BEGINNING OF YEAR							
As previously reported					183,128	3,315	186,443
Prior period adjustment					3,709	(123)	3,586
As restated					<u>186,837</u>	<u>3,192</u>	<u>190,029</u>
NET ASSETS, END OF YEAR					<u>\$ 90,568</u>	<u>\$ 2,195</u>	<u>\$ 92,763</u>

See Accompanying Notes to Financial Statements

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2002  
(amounts expressed in thousands)

	General Fund	Tobacco Tax - Medically Needy Fund	Other Governmental Funds	Total Governmental Funds
<b>ASSETS</b>				
Cash	\$ 66,216	\$ 43,791	\$ 16,157	\$ 126,164
Restricted cash	3,102	-	3,461	6,563
Due from state and county governments	27,081	6,260	74	33,415
Due from the federal government, net	77,125	-	150	77,275
Due from other funds	3,225	-	986	4,211
Receivables and other	445	-	28	473
<b>TOTAL ASSETS</b>	<b>\$ 177,194</b>	<b>\$ 50,051</b>	<b>\$ 20,856</b>	<b>\$ 248,101</b>
<b>LIABILITIES AND FUND BALANCES</b>				
Accounts payable	\$ 2,302	\$ -	\$ -	\$ 2,302
Other accrued liabilities	1,783	-	569	2,352
Deferred revenue	-	-	554	554
Due to federal, state and county governments	48,234	268	3,187	51,689
Due to other funds	938	1,962	216	3,116
Accrued programmatic costs	101,030	-	199	101,229
<b>TOTAL LIABILITIES</b>	<b>154,287</b>	<b>2,230</b>	<b>4,725</b>	<b>161,242</b>
<b>COMMITMENTS AND CONTINGENCIES</b>				
<b>FUND BALANCES</b>				
Reserved	3,102	-	3,461	6,563
Unreserved	19,805	47,821	12,670	80,296
<b>TOTAL FUND BALANCES</b>	<b>22,907</b>	<b>47,821</b>	<b>16,131</b>	<b>86,859</b>
<b>TOTAL LIABILITIES AND FUND BALANCES</b>	<b>\$ 177,194</b>	<b>\$ 50,051</b>	<b>\$ 20,856</b>	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	4,977
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays (\$2,781) exceeded depreciation (\$1,513) in the current period.	(1,268)
Long-term liabilities for accrued paid time off are not due and payable in the current period and therefore are not reported in the funds.	(2,748)
Long-term receivables, offsetting the above accrued paid time off liability, which are not due and receivable in the current period and therefore are not reported in the funds.	2,748
IBNR variance between entire liability on the government-wide financial statements and fund financial statements.	(151,485)
Long-term receivables, offsetting the above IBNR liability which is not due and receivable in the current period and therefore is not reported in the funds.	151,485
<b>NET ASSETS OF GOVERNMENTAL ACTIVITIES</b>	<b>\$ 90,568</b>

See Accompanying Notes to Financial Statements

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS

Year Ended June 30, 2002  
(amounts expressed in thousands)

	General Fund	Tobacco Tax - Medically Needy Fund	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>				
State government:				
Appropriations	\$ 510,248	\$ -	\$ 55,128	\$ 565,376
Pass through funds	245,022	-	-	245,022
Federal government:				
Acute care	1,428,128	-	-	1,428,128
Long-term care	401,323	-	-	401,323
Pass through funds	510,421	-	-	510,421
County government:				
Acute care	71,803	-	-	71,803
Long-term care	169,964	-	-	169,964
Pass through funds	3,750	-	-	3,750
Tobacco litigation settlement revenue	111,955	-	-	111,955
Tobacco tax revenue	-	76,417	-	76,417
Other (primarily investment income)	8,497	1,459	14,950	24,906
<b>TOTAL REVENUES</b>	<b>3,461,111</b>	<b>77,876</b>	<b>70,078</b>	<b>3,609,065</b>
<b>PROGRAMMATIC EXPENDITURES</b>				
Capitation:				
Acute care	1,407,963	1,275	106,455	1,515,693
Long-term care	954,744	-	-	954,744
Children's Rehabilitative Services	33,541	-	-	33,541
Mental health services	388,682	-	-	388,682
Fee-for-service:				
Acute care	277,595	-	18,758	296,353
Long-term care	33,032	-	-	33,032
Disproportionate share	107,874	-	-	107,874
Graduate medical education	18,585	-	-	18,585
Reinsurance	53,244	-	-	53,244
Medicare premiums:				
Acute care	35,210	-	-	35,210
Long-term care	14,624	-	-	14,624
Health Education Centers	18,777	-	-	18,777
Payments to Counties	5,433	-	-	5,433
<b>TOTAL PROGRAMMATIC EXPENDITURES</b>	<b>3,349,304</b>	<b>1,275</b>	<b>125,213</b>	<b>3,475,792</b>
<b>ADMINISTRATIVE EXPENDITURES</b>	<b>162,932</b>	<b>-</b>	<b>16,030</b>	<b>178,962</b>
<b>ADMINISTRATIVE EXPENDITURES PASSED THROUGH</b>	<b>22,554</b>	<b>-</b>	<b>-</b>	<b>22,554</b>
<b>TOTAL EXPENDITURES</b>	<b>3,534,790</b>	<b>1,275</b>	<b>141,243</b>	<b>3,677,308</b>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES</b>	<b>(73,679)</b>	<b>76,601</b>	<b>(71,165)</b>	<b>(68,243)</b>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers out:				
To AHCCCS general fund	-	(44,598)	-	(44,598)
To AHCCCS other fund	(13,405)	-	-	(13,405)
To State general fund	(3,000)	-	(2,805)	(5,805)
To State budget stabilization fund	(3,101)	-	-	(3,101)
To Arizona Department of Health Services	-	(26,292)	(10,500)	(36,792)
To Inter-Agency Service Fund	-	-	(106)	(106)
To Health Crisis Fund	-	(788)	-	(788)
To Arizona Department of Economic Security	(3,750)	(500)	-	(4,250)
To KidsCare Fund	-	(10,700)	-	(10,700)
To Hawaii Arizona PMMIS Alliance	-	-	(42)	(42)
To Healthcare Group	-	(5,055)	-	(5,055)
To Arizona Government Information Technology Agency	(125)	-	-	(125)
Transfers in:				
From General Fund	-	-	13,405	13,405
From Medically Needy	44,598	-	10,700	55,298
From Hawaii Arizona PMMIS Alliance	-	-	42	42
From Stabilization Fund	-	-	83	83
From Arizona Department of Health Services	2,913	10,000	15,000	27,913
<b>TOTAL OTHER FINANCING SOURCES (USES)</b>	<b>24,130</b>	<b>(77,933)</b>	<b>25,777</b>	<b>(28,026)</b>
<b>NET CHANGE IN FUND BALANCES</b>	<b>(49,549)</b>	<b>(1,332)</b>	<b>(45,388)</b>	<b>(96,269)</b>
<b>FUND BALANCES, BEGINNING OF YEAR</b>	<b>72,456</b>	<b>49,153</b>	<b>61,519</b>	<b>183,128</b>
<b>FUND BALANCES, END OF YEAR</b>	<b>\$ 22,907</b>	<b>\$ 47,821</b>	<b>\$ 16,131</b>	<b>\$ 86,859</b>

See Accompanying Notes to Financial Statements

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

Year Ended June 30, 2002  
(Unaudited)

	Original Appropriation (Budget)	Final Appropriation (Budget)	Actual	Variance with Final Budget
<b>REVENUES</b>				
State appropriations	\$ -	\$ -	\$ 511,505	\$ -
Federal government	-	-	1,899,870	-
Federal pass-through funds	-	-	468,147	-
County government	-	-	258,308	-
Tobacco litigation settlement	-	-	111,955	-
Other	-	-	6,447	-
Total revenues	-	-	3,256,232	-
<b>OTHER FINANCING SOURCES</b>				
Operating transfers in	-	-	319,386	-
<b>TOTAL REVENUES AND OTHER FINANCING SOURCES</b>	-	-	3,575,618	-
<b>PROGRAMMATIC EXPENDITURES</b>				
Acute capitation	930,768	1,002,910	999,440	3,470
Acute fee-for-service	311,502	264,778	248,054	16,724
SCHIP Services	-	-	-	-
Reinsurance	53,223	55,902	48,444	7,458
Medicare premiums	33,454	33,652	29,092	4,560
Graduate medical education	21,683	21,683	18,585	3,098
Disproportionate share	53,625	107,874	87,624	20,250
State emergency services	20,000	12,344	10,189	2,155
Breast and cervical cancer	6,733	2,109	14	2,095
Critical access hospitals	1,700	1,237	186	1,051
Freedom to work	500	437	-	437
Long-term care	633,179	648,839	636,552	12,287
<b>TOTAL PROGRAMMATIC EXPENDITURES</b>	2,066,367	2,151,765	2,078,180	73,585
<b>ADMINISTRATIVE EXPENDITURES</b>	124,224	124,999	119,398	5,601
<b>OPERATING TRANSFERS OUT</b>	118,462	83,462	81,737	1,725
<b>TOTAL APPROPRIATED EXPENDITURES</b>	2,309,053	2,360,226	2,279,315	80,911
<b>NON-APPROPRIATED EXPENDITURES</b>	-	-	1,292,790	-
<b>REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES</b>	-	-	3,513	-
<b>FUND BALANCES, BEGINNING OF YEAR</b>	-	-	70,818	-
<b>FUND BALANCES, END OF YEAR</b>	\$ -	\$ -	\$ 74,331	\$ -

See Accompanying Notes to Financial Statements

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## BUDGETARY COMPARISON SCHEDULE - TOBACCO TAX - MEDICALLY NEEDY FUND

Year Ended June 30, 2002  
(Unaudited)

	Original Appropriation (Budget)	Final Appropriation (Budget)	Actual	Variance with Final Budget
<b>REVENUES</b>				
State appropriations	\$ -	\$ -	\$ -	\$ -
Federal government	-	-	-	-
Federal pass-through funds	-	-	-	-
County government	-	-	-	-
Tobacco litigation settlement	-	-	-	-
Other	-	-	78,741	-
<b>TOTAL REVENUES</b>	-	-	78,741	-
<b>OTHER FINANCING SOURCES</b>				
Operating transfers in	-	-	14,338	-
<b>TOTAL REVENUES AND OTHER FINANCING SOURCES</b>	-	-	93,079	-
<b>PROGRAMMATIC EXPENDITURES</b>				
Acute capitation	-	-	-	-
Acute fee-for-service	1,750	1,750	1,275	475
SCHIP Services	-	-	-	-
Reinsurance	-	-	-	-
Medicare premiums	-	-	-	-
Graduate medical education	-	-	-	-
Disproportionate share	-	-	-	-
State emergency services	-	-	-	-
Breast and cervical cancer	-	-	-	-
Critical access hospitals	-	-	-	-
Freedom to work	-	-	-	-
Prescription drug coverage	-	-	-	-
Long-term care	-	-	-	-
<b>TOTAL PROGRAMMATIC EXPENDITURES</b>	1,750	1,750	1,275	475
<b>ADMINISTRATIVE EXPENDITURES</b>	-	-	-	-
<b>OPERATING TRANSFERS OUT</b>	95,157	95,157	91,235	3,922
<b>TOTAL APPROPRIATED EXPENDITURES</b>	96,907	96,907	92,510	4,397
<b>NON-APPROPRIATED EXPENDITURES</b>	-	-	-	-
<b>REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES</b>	-	-	569	-
<b>FUND BALANCES, BEGINNING OF YEAR</b>	-	-	43,222	-
<b>FUND BALANCES, END OF YEAR</b>	\$ -	\$ -	\$ 43,791	\$ -

See Accompanying Notes to Financial Statements

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## STATEMENT OF NET ASSETS - PROPRIETARY FUND

June 30, 2002  
(amounts expressed in thousands)

### ASSETS

#### CURRENT ASSETS

Cash	\$ 4,022
Restricted cash	3,008
Due from other funds	1,914
Receivables and other	<u>21</u>
TOTAL CURRENT ASSETS	8,965

#### CAPITAL ASSETS

Furniture, vehicles and equipment, net of accumulated depreciation	<u>13</u>
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TOTAL ASSETS	<u>\$ 8,978</u>
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### LIABILITIES

#### CURRENT LIABILITIES

Accounts payable	\$ 30
Other accrued liabilities	11
Deferred revenue	2,841
Due to federal, state and county governments	-
Due to other funds	3,009
Accrued programmatic costs	855
Compensated absences due within one year	<u>37</u>

TOTAL CURRENT LIABILITIES	<u>\$ 6,783</u>
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#### COMMITMENTS AND CONTINGENCIES

### NET ASSETS

INVESTED IN CAPITAL ASSETS	\$ 13
RESTRICTED	<u>2,182</u>
TOTAL NET ASSETS	<u>\$ 2,195</u>

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS - PROPRIETARY FUND

Year Ended June 30, 2002  
(amounts expressed in thousands)

OPERATING REVENUES	
Premium revenue	<u>\$ 21,019</u>
OPERATING EXPENSES	
Premiums paid to health plans	19,778
Reinsurance premiums	3,486
Salaries and employee benefits	624
Professional and outside services	209
Other expenses	169
Depreciation	<u>7</u>
TOTAL OPERATING EXPENSES	<u>24,273</u>
OPERATING LOSS	(3,254)
NONOPERATING REVENUE (primarily investment income)	<u>225</u>
LOSS BEFORE TRANSFERS	<u>(3,029)</u>
TRANSFERS IN (OUT)	
To general fund	(14)
To Arizona Tobacco Litigation Settlement Fund	(3,009)
From Tobacco Tax - Medically Needy Fund	<u>5,055</u>
NET TRANSFERS IN (OUT)	<u>2,032</u>
CHANGE IN NET ASSETS	<u>(997)</u>
NET ASSETS, BEGINNING OF YEAR	
As previously reported	3,315
Prior period adjustment	<u>(123)</u>
As restated	<u>3,192</u>
NET ASSETS, END OF YEAR	<u>\$ 2,195</u>

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## STATEMENT OF CASH FLOWS - PROPRIETARY FUND

Year Ended June 30, 2002  
(amounts expressed in thousands)

### CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from customers	\$ 20,469
Payments to health plans	(23,648)
Payments to employees	(587)
Payments to suppliers	(359)
Net cash used in operating activities	<u>(4,125)</u>

### CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Operating subsidies from other funds	3,141
Return of prior year operating subsidies from other funds	(14)
Net cash provided by noncapital financing activities	<u>3,127</u>

### CASH FLOWS FROM INVESTING ACTIVITIES

Increase in restricted cash	(3,008)
Interest	228
Net cash used in investing activities	<u>(2,780)</u>

NET CHANGE IN CASH (3,778)

### CASH, BEGINNING OF YEAR

As previously reported	7,923
Prior period adjustment	(123)
As restated	<u>7,800</u>

CASH, END OF YEAR \$ 4,022

### RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES

Operating loss	\$ (3,254)
Adjustment to reconcile operating loss to net cash used in operating activities:	
Depreciation	7
Changes in operating net assets and liabilities:	
Increase in accounts payable and other accruals	19
Decrease in deferred revenue	(550)
Decrease in accrued programmatic costs	(384)
Increase in accrued compensated absences	37
NET CASH USED IN OPERATING ACTIVITIES	<u>\$ (4,125)</u>



# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (1) Company operations

*Company operations* – The **Arizona Health Care Cost Containment System** ("AHCCCS" or the "Agency"), an agency of the state of Arizona (*State*), was established by the Arizona Legislature in November 1981 to administer health care for the State's indigent population. AHCCCS is a *State* agency managed by an independent cabinet level administration created by the Arizona Legislature, and it is funded by a combination of federal, state and county funds. The federal portion is funded through the Centers for Medicare and Medicaid Services (CMS) of the U.S. Department of Health and Human Services under a Section 1115 waiver approved by CMS, which exempts the AHCCCS program from certain requirements of conventional Medicaid programs. This waiver has been renewed by CMS through September 30, 2006. AHCCCS receives quarterly federal grants from CMS (as matching funds) to cover a portion of the health care costs of the residents of the State, eligible for the State's Title XIX (Medicaid) and Title XXI, State Children's Health Insurance Program (CHIP). State appropriations and county funds are based on a yearly budget as dictated by the Arizona Legislature and specified in Arizona Session Law.

AHCCCS provides acute and long-term health care coverage to eligible residents of Arizona. Eligible residents include those who qualify under Section 1931(b) of the Social Security Act, Supplemental Security Income (SSI), children who meet certain age requirements from families receiving food stamps, and children and pregnant women whose household income meets eligibility requirements.

Under AHCCCS, health care coverage is provided substantially through a competitive bidding process with private and county-sponsored health plans bidding for the enrollment of AHCCCS eligibles by geographical service area. In addition, AHCCCS purchases health care services directly from providers.

Other AHCCCS lines of business include the Healthcare Group, which provides prepaid medical coverage primarily to small businesses, and the Premium Sharing Program, which provides coverage to individuals who meet certain income criteria and who are not covered through other health insurance programs. The activities of the Healthcare Group are included in the proprietary fund. See Notes 8 and 9 for more information on these programs.

### (2) Agency-wide and fund financial statements

The agency-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on the entire Agency. The effect of all significant interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the governmental and business-type activities direct expenses are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include appropriations, contributions and grants that are restricted to meeting the operational or capital requirements of a particular function or segment.

Separate financial statements are provided for the governmental and proprietary funds. AHCCCS has one major fund, the Tobacco Tax and Health Care Fund - Medically Needy Account, and one business-type activity, Healthcare Group.

### (3) Measurement focus, basis of accounting and financial statement presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (3) **Measurement focus, basis of accounting and financial statement presentation (continued)**

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, AHCCCS considers revenue to be available if they are collected within 30 days of the end of the current fiscal year. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

AHCCCS reports the following significant governmental funds:

- The general fund which is AHCCCS' primary operating fund for the Title XIX Medicaid program.
- The Tobacco Tax and Health Care Fund - Medically Needy Account fund that accounts for all financial resources from a dedicated tax funding source to support various health programs through legislative appropriations or allocations.
- Additionally, AHCCCS reports the following fund types:
  - The Healthcare Group fund reported as a business-type activity accounts for the activities of a prepaid medical coverage program primarily to small, uninsured businesses with 1 to 50 employees and employees of political subdivisions.
  - Special revenue funds reported as other funds account for various health and administrative programs.

### (4) **Summary of significant accounting policies**

The accounting policies of AHCCCS conform to U.S. generally accepted accounting principles applicable to governmental units. The financial statements of AHCCCS, as a department of the state of Arizona, are not intended to represent the related financial statement information of the primary government. The following is a summary of the significant accounting policies.

*Revenues and Expenditures - Governmental Funds* - Revenues and other financial resources are recognized in the accounting period in which they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at fiscal year end. Expenditures and other uses of financial resources are recognized when the related fund liability is incurred. Accrued programmatic costs include estimates for incurred but not reported (IBNR) claims for a 30-day period following the end of the fiscal year. Actual results for accrued programmatic costs may differ from such estimates. These differences are recorded in the period that they are identified.

*Revenues and Expenses - Proprietary Fund* - Revenues are recognized when they are earned and expenses are recognized when they are incurred. Premiums are due by the first day of the month preceding the month of coverage. At June 30, 2002, the deferred revenue balance was comprised of premium payments received for the months of July and August 2002.

*Encumbrances* - Purchase orders, contracts and other commitments for expenditures are encumbered in order to reserve that portion of the applicable appropriation. This practice is employed as an extension of formal budgetary control. Total encumbrances outstanding at June 30, 2002 were \$111,461.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (4) Summary of significant accounting policies (continued)

*Cash and Investments* - Substantially all of the cash and investments maintained by AHCCCS is held by the state of Arizona Office of the Treasurer (the "Treasurer"). The cash and investments are invested by the Treasurer with other State monies. Investment income is allocated to AHCCCS on a pro rata basis. Amounts held by the Treasurer are recorded at fair value and totaled \$138,539 at June 30, 2002.

The State is statutorily limited (by ARS §35-312 and §35-313) to certain investment types. Additionally, State statutes require the State to make investments in accordance with the "Prudent Person" rule. This rule imposes the responsibility of making investments with the judgment and care that persons of ordinary prudence would exercise in the management of their own affairs when considering both the probable safety of their capital and the probable income from that capital. The Treasurer issues a separately published Annual Financial Report that provides additional information relative to the Treasurer's total investing activities.

A portion of cash in the General Fund is restricted in the amount of \$3,102 for the Arizona Tobacco Litigation Settlement Fund (ATLSF). The Other Funds include restricted amounts of \$961 for the Hawaii Arizona PMMIS Alliance (HAPA) project and \$2,500 for the Medical Services Stabilization Fund as described in Note 8.

In accordance with the Federal Cash Management Improvement Act guidelines, AHCCCS may only request federal funds under specified funding techniques. These techniques require that AHCCCS draw down or request funds for any check issued in accordance with its historical average check-clearing pattern. The timing difference that occurs, due to drawing down funds after the issuance of checks, may result in bank overdrafts to AHCCCS at various times during the year. At June 30, 2002, no bank overdraft existed.

*Capitation Payments* - AHCCCS' contracted health plans receive fixed capitation payments, generally in advance, based on certain rates for each AHCCCS member enrolled with the plan. The plans are required to provide all covered health care services to their members, regardless of the cost of care. If there are funds remaining, the plan retains the funds as profit; if the costs are higher than the amount of revenue received, the plan absorbs the loss, except for those cases eligible for reinsurance payments.

AHCCCS capitates its contracted health plans for the cost of providing medical services to eligible persons. Capitation is paid prospectively as well as for prior period coverage (PPC). The PPC period is from the first day of the month of application to the time of enrollment with a contracted health plan. AHCCCS reimburses the health plans for the amount that actual PPC medical expenses exceed total capitation and reinsurance paid by AHCCCS for the eligible individual. Accrued programmatic costs include approximately \$10,061 at June 30, 2002, that represents estimated settlements payable to contracted health plans for PPC. Actual results may differ from this estimate and such differences will be recorded in the period in which they are identified.

*Reinsurance Payments* - AHCCCS provides a stop-loss reinsurance program for its contracted health plans for partial reimbursement, after a deductible is met, of covered inpatient facility medical services incurred for members with an acute medical condition. For long-term care members, the program includes a deductible which varies based on the health plan's member enrollment and the eligibility category of their members. For acute care members, health plans choose their deductible level for all eligibility groups. AHCCCS reimburses the health plans based on a coinsurance amount for inpatient-covered services incurred above the deductible.

The reinsurance program provides coverage for the PPC time period. PPC cases are reimbursed at 100% after the deductible of \$5 is met. This deductible level applies to all health plans.

The reinsurance program also includes a special catastrophic reinsurance program, which covers conditions such as certain brain injuries, certain blood related disorders or those conditions resulting in covered organ transplantation. There is no deductible for catastrophic reinsurance cases, and AHCCCS reimburses the health plans at a percentage of the health plan's adjusted billed charges up to \$650 at which point all adjusted billed charges are covered.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (4) Summary of significant accounting policies (continued)

*Fee-for-Service Payments* - The AHCCCS program is responsible for the cost of providing medical services on a fee-for-service basis to three populations: persons enrolled in the Emergency Services Program (ESP), persons enrolled in a health plan for less than 30 days, and Native American members enrolled with Indian Health Services (IHS).

The ESP provides for emergency medical care to persons who are ineligible for full AHCCCS coverage due to their lack of United States citizenship or lawful alien status. Effective March 1, 2002, hospital inpatient and outpatient medical service are no longer eligible for reimbursement.

Prior to March 1, 2002, inpatient and outpatient medical services for the ESP and for members enrolled in a health plan for less than 30 days were reimbursed at capped fee-for-service rates based on the category of service provided. Inpatient medical services for these populations were reimbursed based upon an inpatient per diem reimbursement rate system.

Medical services provided at an IHS facility or by a tribal-owned facility licensed by IHS are reimbursed at rates determined by the Office of Management and Budget (OMB). Off-reservation services are reimbursed based on the AHCCCS inpatient and outpatient fee-for-service rates.

*Incurred but not reported expenses* - Medical expenditures include capitation, fee-for-service, and reinsurance expenses. Fee-for-service and reinsurance expenditures include claims paid, claims in process and pending, and the estimate made by management for incurred but not reported (IBNR) claims and charges by physicians, hospitals and other healthcare providers for services rendered to eligible members during the period.

The estimates for IBNR claims are developed using actuarial methods based upon historical data for payment patterns and other relevant factors. Such liabilities are necessarily based on assumptions and estimates, and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed and adjustments are reflected in the period determined.

*Disproportionate Share Hospital Payments* - During 2002, CMS and the Arizona Legislature authorized AHCCCS to make a disproportionate share payment to Arizona hospitals that had provided care to a disproportionate share (as defined) of the State's indigent population. Expenditures for disproportionate share totaled \$107,874 for the year ended June 30, 2002. At June 30, 2002, accrued programmatic costs include \$20,250 of disproportionate share payable.

*Taxes* - AHCCCS is an agency of the state of Arizona and is not subject to income taxes.

*Use of Estimates* - The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at June 30, 2002, and the reported amounts of revenues and expenditures during the fiscal year then ended. Due to the prospective nature of estimates, actual results may differ from those estimates.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

(4) **Summary of significant accounting policies (continued)**

*100% Federal Poverty Level Expansion and CMS Waiver* - On November 7, 2000, the Arizona voters approved ballot Proposition 204. One of its primary components directed AHCCCS to increase the minimum qualifying income eligibility level up to 100% of the Federal Poverty Level. The proposition also designated AHCCCS as the administrator of the Tobacco Litigation Settlement funds awarded to the State for compensation of costs incurred in providing its citizens with health care and other services necessitated by the use of tobacco products.

AHCCCS obtained a waiver from CMS to receive Federal funding for the newly eligible populations and to fund additional legislation passed during the 2001 State legislative session to implement Proposition 204. The CMS waiver requires that the newly covered population not previously categorically eligible for Medicaid be budget neutral for CMS. The waiver period for budget neutrality began April 1, 2001 and extends through federal fiscal year 2006 at which time any federal funds received by the State that exceed the negotiated budget neutrality limit must be returned to CMS. Because any future settlement amount is currently not measurable, a liability for any excess federal funds has not been recorded.

AHCCCS has classified the Arizona Tobacco Litigation Settlement Fund, created by ballot Proposition 204, as part of its General Fund. These funds are restricted for use as specified in litigation settlement and/or legislation. Annual settlement payments (\$80,901 in fiscal 2002) are made in April. In addition to annual payments, the agreement requires that five one-time payments (of \$29,487) be made in January of each year. At June 30, 2002, the final one-time payment remains outstanding. These payments are subject to several adjustments for such factors as cigarette production and annual sales volume that are not presently determinable. Therefore, an accrual was not made for these payments at June 30, 2002.

(5) **Capital assets**

Capital assets, which consist of furniture, vehicles and equipment, are reported in the governmental and business-type activity columns in the government-wide statement of net assets. Capital assets are defined as assets with an initial, individual cost of more than \$5 and an estimated useful life in excess of two years. Such assets are recorded at historical cost and are depreciated over their useful lives ranging from 2 to 10 years. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. The assets retired in the amount of \$1,361 in the current fiscal year were fully depreciated. Net asset balances and current fiscal year activity are as follows:

Balance, June 30, 2001	\$ 3,730
Additions	2,781
Retirements	-
Depreciation	(1,521)
Balance, June 30, 2002	<u>\$ 4,990</u>

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (6) Compensated absences

It is the State's policy to permit employees to accumulate earned but unused vacation, compensatory and sick pay benefits. There is no liability recorded on AHCCCS' financial statements for sick leave as any amounts eligible for payment when employees separate from State service are the responsibility of the Arizona Department of Administration. Amounts recorded in the government-wide financial statements consists of employees' vested accrued vacation and accrued compensatory time benefits, other than sick leave which is accrued and payable by the State.

Balance, June 30, 2001	\$ 2,486
Additions	3,222
Reductions	(2,923)
Balance, June 30, 2002	<u>\$ 2,785</u>

All compensated absences are due within one year.

### (7) Tobacco Tax and Health Care Fund – Medically Needy Account

The Arizona Department of Revenue allocates funding to AHCCCS' Major Fund, the Tobacco Tax and Health Care Fund – Medically Needy Account. The Tobacco Tax and Health Care Fund – Medically Needy Account provides funding for services provided through the Title XIX Medicaid and Title XXI KidsCare programs and other legislatively authorized health related services or programs. Revenue sources for the Tobacco Tax and Health Care Fund – Medically Needy Account include Tobacco Tax proceeds and investment income. At June 30, 2002, the Major Fund balance was \$47,821. Amounts earned, expended and transferred during the fiscal year ended June 30, 2002 were as follows:

	Tobacco Tax and Health Care Fund - Medically Needy Account
Fund balance, June 30, 2001	\$ 49,153
Receipts	76,417
Interest earned	1,459
Expenditures	(1,275)
Transfers:	
General fund	(44,598)
Arizona Department of Health Services (ADHS)	(26,292)
Health crisis fund	(788)
Arizona Department of Economic Security (ADES)	(500)
KidsCare	(10,700)
Healthcare Group	(5,055)
Arizona Department of Health Services (ADHS)	10,000
Fund balance, June 30, 2002	<u>\$ 47,821</u>

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (8) Other funds

At June 30, 2002, the other fund balance of \$16,131 was comprised of the following funds:

- Medical Services Stabilization Fund - the purpose of which is to offset increases in the cost of providing services to certain eligible members. This fund was originally funded by the Tobacco Tax and Health Care Fund - Medically Needy Account. Any remaining funds will be transferred back to the Tobacco Tax and Health Care Fund - Medically Needy Account at June 30, 2003.
- Premium Sharing Program Fund - the purpose of which is to provide a medical services coverage program for the uninsured funded from Tobacco Tax proceeds and premiums collected from participants.
- Third Party Liability Fund - which is comprised of monies recovered from first and third party payers under various AHCCCS recovery programs. These programs include casualty, special treatment trusts, estate and health insurance recoveries.
- KidsCare Fund - which encompasses Arizona's Title XXI State Children's Health Insurance Program that provides comprehensive healthcare coverage to targeted low-income children up to the age of 19. The program is funded from member premiums, Tobacco Tax proceeds and federal funds.
- Miscellaneous Funds - which account for various grants and other monies received for specific purposes. This includes the Hawaii Arizona PMMIS Alliance (HAPA). HAPA represents AHCCCS' project with Hawaii whereby AHCCCS processes the claim for Hawaii's Medicaid program.

Other funds earned, expended and transferred during the fiscal year ended June 30, 2002 were as follows:

	Medical Services Stabiliza- tion Fund	Premium Sharing Program Fund	Third Party Liability Fund	KidsCare Fund	Miscell- aneous Funds	Total
Fund balances, June 30, 2001	\$ 23,394	\$ 27,037	\$ 2,733	\$ 7,541	\$ 814	\$ 61,519
Receipts	-	-	-	54,947	181	55,128
Interest earned	1,128	3,077	954	2,042	7,749	14,950
Expenditures	(42,404)	(21,810)	(485)	(69,197)	(7,347)	(141,243)
Transfers:						
ADHS	4,500	-	-	-	-	4,500
General Fund	13,405	-	-	-	-	13,405
ISA Fund	(106)	-	-	-	-	(106)
Medically Needy Account	-	-	-	10,700	-	10,700
Other	83	-	(2,400)	-	(405)	(2,722)
Fund balances, June 30, 2002	\$ -	\$ 8,304	\$ 802	\$ 6,033	\$ 992	\$ 16,131

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (9) Proprietary fund

The Healthcare Group was established in 1988 by the state of Arizona to administer prepaid medical coverage primarily to small, uninsured businesses with 1 to 50 employees and employees of political subdivisions. Healthcare Group Administration (HCGA) contracts with two health plans from the existing network of the AHCCCS-funded health plans to enroll members and provide healthcare services. HCGA conducts premium billing, collections and fund disbursement, data analysis and is responsible for the regulatory oversight of the health plans.

For *State* fiscal year 2002, the Arizona Legislature authorized an appropriation of up to \$6 million from the Tobacco Tax and Health Care Fund - Medically Needy Account for the Healthcare Group, to be allocated among Healthcare Group health plans based on the budget projections of the plans. This allocation is included in transfers in the accompanying statement of revenues, expenses and changes in fund net assets – proprietary fund. Current legislation only provides the appropriated funding for Healthcare Group through fiscal year 2003.

### (10) Retirement plan

AHCCCS employees are covered by a defined benefit retirement plan administered by the Arizona State Retirement System Board. Benefits are established by *State* statute and provide retirement and long-term disability benefits to AHCCCS employees. The retirement plan is funded by payroll deductions from eligible employees' gross wages and matching amounts contributed by AHCCCS. These amounts satisfy the statutory requirement that employees and AHCCCS contributions must cover the actuarially determined current service costs of the retirement plan, plus amortization over a 30-year period of the unfunded past service liability. Payroll deductions as a percentage of employee wages were 2.0% for retirement and .49% for long-term disability for 2002. The matching amount contributed to the retirement plan by AHCCCS was \$1,093 in 2002 and is included in administrative expenditures in the accompanying statement of revenues, expenditures and changes in fund balances - governmental funds.

Retirement benefit payments are obligations of the retirement plan and not AHCCCS. Actuarial and financial data on the retirement plan are available from the retirement plan's separately issued Comprehensive Annual Financial Report.

### (11) Budgetary basis of accounting

The financial statements of AHCCCS are prepared in conformity with U.S. generally accepted accounting principles (GAAP) basis. AHCCCS, like all other state of Arizona agencies, prepares its annual budget on a basis which differs from the GAAP basis. The State's accounting system and Arizona Revised Statutes and policies provide for an additional accounting period (13<sup>th</sup> month) to make payments for goods or services received or incurred by the end of the fiscal year and subsequently invoiced during the 13<sup>th</sup> month. The statements report total budget basis expenditures to include both the fiscal year and the 13<sup>th</sup> month activity. The State does not have a legally adopted budget for revenues. The reported appropriated (budget) amount is the final fiscal year appropriation after any adjustments plus any prior fiscal year expenditures paid in the current fiscal year in accordance with the administrative adjustment procedures as authorized by Arizona Revised Statutes. AHCCCS' controlling statute for program administrative adjustment procedures varies from the statutory requirement of other State agencies. AHCCCS is permitted to pay for approved system covered medical services presented after the close of the fiscal year in which they were incurred with either remaining prior year or current year available monies. This provides the opportunity for program expenditures to equal the appropriation (budget) amount.



# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (11) Budgetary basis of accounting (continued)

The following is a reconciliation of the GAAP basis fund financial statements to the budget basis for the year ended June 30, 2002:

	General Fund Actual	Tobacco Tax - Medically Needy Actual
Budgetary basis fund balance, June 30, 2002	\$ 74,331	\$ 43,791
Basis of accounting differences:		
Increases to fund balance:		
Due from State and county governments	67,920	5,066
Due from the Federal government	186,409	-
Due from other funds	3,008	-
Receivables and other	1,353	-
Total increases	258,690	5,066
Decreases to fund balance:		
Deferred revenue	-	-
Due to State and county governments	(9,457)	-
Due to the Federal government	(9,806)	-
Due to other funds	(26,803)	(1,036)
Accrued programmatic costs	(251,427)	-
Payables and other	(12,621)	-
Total decreases	(310,114)	(1,036)
Total GAAP basis fund balance	\$ 22,907	\$ 47,821

Non-appropriated expenditures of \$1,293 in the general fund consist of federal pass-through payments to other agencies and Proposition 204 expansion program payments.

### (12) Contingencies

*Grant adjustment* - Amounts received from CMS are subject to audit and adjustments. At June 30, 2002, AHCCCS had claimed reimbursement from CMS on its Form CMS-64 of approximately \$55.7 million representing additional reimbursement AHCCCS believes it is due for health care services provided to Native Americans off the reservation. CMS disallowed this claim during 2001. AHCCCS appealed this decision and the Department of Health and Human Services' Department Appeals Board upheld the disallowance. As a result, AHCCCS has not drawn down these funds from CMS nor are they included in the accompanying financial statements. AHCCCS believes reimbursement of these funds is supported in law and intends to continue to pursue recovery of these funds through Federal legislative effort.

*Litigation and investigations* - AHCCCS has been named as a defendant in a variety of litigation, all of which are being defended by legal counsel. It is the opinion of AHCCCS, upon consultation with legal counsel, that none of these claims is likely to have a material adverse effect on AHCCCS' financial statements. In addition, AHCCCS believes that the funding of any material adverse judgment, sanction or repayment obligation in excess of its appropriation would require a special appropriation by the State.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (12) Contingencies (continued)

*Compliance with laws and regulations* - AHCCCS is subject to numerous laws, regulations and oversight by the federal government. These laws and regulations include, but are not necessarily limited to, matters such as government health care program participation requirements, reimbursement for member services and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant financial sanctions. Management believes that AHCCCS is in compliance with fraud and abuse laws and regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown at this time.

### (13) Interfund receivables, payables and transfers

Interfund activity is defined as transactions between funds administered by AHCCCS. The composition of interfund balances as of June 30, 2002 is as follows:

<u>Receivable fund</u>	<u>Payable fund</u>	<u>Amount</u>
General fund	Healthcare Group	\$ 3,009
	HAPA – Other Fund	216
Other funds	Tobacco Tax - Medically Needy Fund	48
	General Fund	938
Proprietary fund	Tobacco Tax - Medically Needy Fund	<u>1,914</u>
Total		<u>\$ 6,125</u>

The total due from other funds and due to other funds amount of \$6,125 has been eliminated in the accompanying government-wide statement of net assets.

	<u>Transfers in</u>			
	<u>General</u>	<u>Other</u>	<u>Healthcare Group</u>	<u>Total</u>
Transfers out:				
General fund	\$ -	\$ 13,405	\$ -	\$ 13,405
Tobacco Tax - Medically Needy Fund	44,598	10,700	5,055	60,353
Healthcare Group	<u>3,009</u>	<u>-</u>	<u>-</u>	<u>3,009</u>
	<u>\$ 47,607</u>	<u>\$ 24,105</u>	<u>\$ 5,055</u>	<u>\$ 76,767</u>

In the government-wide statement of activities, the interfund activity has been eliminated. The total net transfers out of \$25,729 represents transfer activities to other state departments.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (14) Transactions with other State agencies

*Transactions with other State agencies* - AHCCCS contracts for administrative and programmatic services from other State agencies. Charges for administrative services are based on the performing agencies' actual cost. Charges for programmatic services are generally based on actuarially determined capitation rates. The following is a summary of contracted services provided.

*Administrative services* - The state of Arizona's Department of Economic Security (DES) charges AHCCCS to determine eligibility for certain Title XIX members. The State's Department of Administration charges AHCCCS for data center services and equipment costs. The State's Department of Health Services (DHS) charges AHCCCS for licensure and preadmission screening and resident review services. These expenditures are included in administrative expenditures in the accompanying statement of revenues, expenditures and changes in fund balances - governmental fund. The following is a summary of transactions with these State agencies for the services described above for the year ended June 30, 2002.

	<u>Expenditures</u>
Department of Economic Security	\$ 42,815
Department of Administration	4,678
Department of Health Services	1,090
	<u>\$ 48,583</u>

*Programmatic services* - Certain health care-related programmatic services are provided by other State agencies, which include DES and DHS. AHCCCS receives the State and federal funds for these services and transfers them to the appropriate agencies pursuant to the terms of intergovernmental agreements. The total amount of federal funds received by AHCCCS and passed through to these agencies was \$466,654 in 2002. The total amount of State funds received by AHCCCS and passed through to these agencies was \$245,022 in 2002. The amount passed through to DES was \$253,525 of federal funds and \$135,945 of State funds in 2002 and is classified as long-term care capitation programmatic expenditures in the accompanying governmental funds statement of revenues, expenditures and changes in fund balances. The amount passed through to DHS was \$213,129 of federal funds and \$109,077 of State funds in 2002 and is classified as capitation-mental health services and Children's Rehabilitative Services expenditures in the accompanying statement of revenues, expenditures and changes in fund balance - governmental funds.

Revenues include \$241,767 from Arizona Counties during fiscal 2002. To the extent expenditures for long-term care services are less than county and State contributions, AHCCCS is required to remit such amounts equally to the State and the counties. At June 30, 2002, AHCCCS has accrued \$3.3 million, payable 50% to the State and 50% to the counties, relating to the amount that county and State contributions will exceed related expenditures. This amount is included in the due to federal, State and county governments in the accompanying balance sheet - governmental funds.

### (15) Other pass through funds

Arizona school districts are eligible for federal matching funds for the administrative functions related to Early and Periodic Screening, Diagnosis and Treatment (EPSDT) outreach services at the school level. The total amount of federal funds received by AHCCCS and passed through to Arizona school districts was \$20,316 in 2002. Arizona school districts are also eligible for federal matching funds on a fee-for-service basis for the provision of certain AHCCCS program services provided to eligible students. The total amount passed through to Arizona school districts was \$21,135 in 2002. These amounts are included within federal pass through funds in the accompanying statement of revenues, expenditures and changes in fund balances - governmental funds.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2002  
(amounts expressed in thousands)

### (15) Other pass through funds (continued)

Arizona's 15 counties are eligible for federal matching funds for administrative functions relating to certain eligibility determinations. The counties contract with AHCCCS to obtain these federal funds. The total amount passed through to the counties in 2002 was \$2,238. Approximately \$79 was passed through to DHS in connection with an agreement between DHS and the Federal Department of Health and Human Services. The amount of \$22,554 is classified as administrative expenditures passed through and the amount of \$510,421 is classified as revenue pass through funds on the accompanying statement of revenues, expenditures and changes in fund balance - governmental funds.

### (16) New pronouncements

AHCCCS adopted the following pronouncements during 2002:

- GASB Statement No. 34 - *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*: This statement modifies the requirements for the basic financial statements of governments and governmental agencies to include Management's Discussion and Analysis, which introduces the basic financial statements and provides an analytical overview of the financial activities. Required supplementary information will also be required to include budgetary comparison schedules. This statement was effective for AHCCCS for its fiscal year beginning July 1, 2001.
- GASB Statement No. 38 - *Certain Financial Statement Notes Disclosures*: This statement modifies, establishes and rescinds certain financial statement disclosure requirements for general purpose external financial reporting by state and local governments. This statement was effective simultaneously with GASB Statement No. 34.

### (17) Subsequent events

The State's General Fund revenue collections have been less than the budget expectations beginning in late fiscal year 2002 and that trend has been continued into fiscal year 2003. This economic downturn has resulted in a significant decline in the State's revenue stream. AHCCCS' management is currently unable to estimate the budgetary impact on its operations for fiscal year 2003 and beyond. However, AHCCCS has prepared plans to reduce both the administrative and program budgets to the extent possible, and fully expects some level of budget cuts for fiscal year 2003 and beyond to be dictated by the Arizona Legislature as specified in Arizona Session Law. The financial statements have not been adjusted for any changes that might result from the outcome of this uncertainty.

### (18) Prior period adjustment – correction of an error

The net assets at the beginning of the year in the accompanying statement of revenues, expenses and changes in fund net assets – proprietary fund at June 30, 2002 has been restated to correct an error in the prior period related to claims expense and cash. Cash was overstated and claims expense was understated as a result of certain claims not being recorded. The effect of the restatement was to decrease cash and net assets and increase claims expense by \$123 at and for the year ended June 30, 2001.

## **ADDITIONAL INFORMATION**

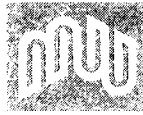
# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

## SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year Ended June 30, 2002

(Amounts in Thousands)

<u>Federal Grantor/Pass Through Agency</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>
<b>U.S. Department of Health and Human Services</b>		
Centers for Medicare and Medicaid Services		
Medicaid Program (Title XIX)	93.779	
Federal funds expended to vendors		\$ 2,426,524
Federal funds expended to subrecipients		<u>22,633</u>
		2,449,157
 State Children's Health Insurance Program (Title XXI)	 93.767	 55,769
 Maternal and Child Health Bureau	 93.926B	
Healthy Start South Phoenix Project		181
 Health Resources and Services Administration	 93.000	
State Planning Grant - Health Care Access for the Uninsured		<u>826</u>
 Total Federal Awards Expended		 <u>\$ 2,505,933</u>



REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Director of the  
**Arizona Health Care Cost Containment System**

We have audited the financial statements of the **Arizona Health Care Cost Containment System (AHCCCS, an agency of the state of Arizona)** at June 30, 2002 and for the year then ended, and have issued our report thereon dated November 27, 2002. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the **Arizona Health Care Cost Containment System's** financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the **Arizona Health Care Cost Containment System's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses.

This report is intended solely for the information and use of the management of **Arizona Health Care Cost Containment System** and the state of Arizona Auditor General and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

*Miller Wagner & Company, PLLC*

November 27, 2002  
Phoenix, Arizona